

CA1  
EA 1  
-1999  
D07

GOVT









Digitized by the Internet Archive  
in 2022 with funding from  
University of Toronto

<https://archive.org/details/31761115535809>

CA1  
EA1  
- 1999  
DO.7

Government  
Publications

①



Department of Foreign Affairs  
and International Trade

Ministère des Affaires étrangères  
et du Commerce international

**CANADA**

**GOVERNMENT INTERVENTION IN  
INTERNATIONAL MARITIME SERVICES:**

**AN ANALYSIS OF CANADA'S ECONOMIC  
INTERESTS IN THE CONTEXT OF THE  
GATS NEGOTIATIONS**

by

**Richard Saillant**

**The Trade and Economic Analysis Division (EET)  
Department of Foreign Affairs and International Trade**

June 1999

Reference Document No.7





*Department of Foreign Affairs  
and International Trade*

**Reference Document No. 7**

---

**GOVERNMENT INTERVENTION IN  
INTERNATIONAL MARITIME TRANSPORT SERVICES:  
AN ANALYSIS OF CANADA'S ECONOMIC INTERESTS  
IN THE CONTEXT OF THE GATS NEGOTIATIONS**

by

Richard Saillant

Trade and Economic Analysis Division (EET)  
Department of Foreign Affairs and International Trade

June 1999



**The Government Intervention in International Maritime Services: An Analysis of Canada's Economic Interests in the Context of the GATS Negotiations**, by Richard Saillant, Government of Canada (Department of Foreign Affairs and International Trade Canada) 1999.

Cat. No. E73-16/7-1999E



## Table of Contents

|   |    |
|---|----|
| Acknowledgement .....   | 4  |
| Executive Summary .....   | 6  |
| Introduction .....  | 7  |
| Chapter I: The Importance of Maritime Transport in Domestic<br>and in World Trade .....                     | 10 |
| 1.1 Canada's domestically registered fleet .....  | 10 |
| 1.1.1. Domestic Traffic .....   | 11 |
| 1.1.2. Transborder Traffic .....  | 12 |
| 1.2 Canada's participation in international maritime transport<br>through vessels registered abroad .....   | 13 |
| 1.2.1 Ownership and control of foreign-registered vessels by Canadian companies ..                          | 14 |
| 1.2.2 Management of foreign-registered vessels on behalf of foreign companies ....                          | 15 |
| 1.3 An overview of the world's seaborne trade and merchant marine fleet .....                               | 16 |
| 1.3.1 Major commodities and trading routes .....  | 16 |
| 1.3.2 Countries of registry .....   | 16 |
| 1.3.3 Ownership of the world fleet .....  | 17 |
| Chapter II: International Competitiveness and Government Intervention<br>in the Maritime Sector .....       | 19 |
| 2.1 Government intervention and international competitiveness: the links .....                              | 19 |
| 2.2 Fiscal incentives .....   | 21 |
| 2.2.1 Definition .....  | 21 |
| 2.2.2. A classification of fiscal incentives and an overview of their<br>their usage across the world ..... | 22 |
| 2.2.2.1 Fiscal Incentives aimed at reducing capital costs .....   | 22 |
| 2.2.2.2 Fiscal incentives aimed at reducing operating costs .....   | 26 |
| 2.2.2.3 Fiscal incentives aimed at reducing corporate tax burdens .....                                     | 30 |

|       |  |    |
|-------|--|----|
| 2.2.3 | Economic implications for Canada .....   | 31 |
| 2.3   | Crew members nationality requirements, manning and other<br>safety regulations ..... | 33 |
| 2.3.1 | Crew members nationality requirements .....  | 33 |
| 2.3.2 | Manning and other safety regulations .....   | 33 |
| 2.3.3 | Economic implications for Canada .....   | 34 |
| 2.4   | Flag discrimination .....  | 35 |
| 2.4.1 | Cargo sharing agreements and cargo preference policies .....                         | 35 |
| 2.4.2 | Restrictions to access to port and auxiliary services .....                          | 37 |
| 2.4.3 | Restrictions to the establishment of multimodal services .....                       | 38 |
| 2.4.4 | Economic implications for Canada .....   | 39 |
|       | Conclusion .....   | 41 |
|       | Bibliography .....   | 42 |



## ACKNOWLEDGEMENT

The author would like to acknowledge the useful comments and advice provided in the preparation of this paper from several individuals working at Transport Canada, Industry Canada, and the Department of Foreign Affairs and International Trade (DFAIT).

At Transport Canada, I am particularly grateful to Les Ward, whose depth of information and analysis, as well as his guidance, were essential to this paper. Robert Snider, for his part, provided helpful reference documents and useful comments throughout the drafting of the paper.

I would also like to thank Emile Rochon, from Industry Canada, whose comments on my text in general, and the subsection on shipbuilding subsidies in particular, were very helpful.

At DFAIT, my thanks to John Curtis, Robert Stranks, Christine Roy, Chantal Blouin and Todd Hunter for their comments, useful tips and in many instances, proofreading my English.

Of course, the views expressed in this paper are the author's and do not represent those of DFAIT. All errors are the sole responsibility of the author.

## UNITS OF MEASUREMENT: SOME DEFINITIONS

The following three units of measurement of a ship's capacity are used in this report. They may not be familiar to some readers:

**Gross register tonne/tonnage (grt/gt):** the total of all the enclosed spaces within a ship, expressed in tons/ tonnes, each basic unit of which equals 100 cubic feet/2.831 cubic metres. The term grt is progressively being replaced by "gross tonnage (gt)", also calculated in basic units of 100 cubic feet/2.831 cubic metres, as defined by the 1969 Convention on Tonnage Measurement of ships which came into force in 1982, but which contains a 12-year transitional period.

**Deadweight tonnage (dwt):** a ship's dwt indicates the maximum in tons/tonnes of cargo, stores, fuel and domestic water that may be loaded before her loadline (unless otherwise stated, the summer loadline) is submerged. Dwt can also be expressed in terms of size, each unit of which measures 40 cubic feet or less/one cubic metre or less.

**TEU:** twenty-foot equivalent units. The basis unit for expressing the capacity for carrying containers upon fully cellular, part-container, or ro/ro vessels. The purpose of this unit is to put on a single basis, ships designed to move containers of 20, 35 or 40 feet in length, with a standard height and width of eight feet.

Source: Sullivan, E., *Marine Encyclopaedic Dictionary*, London, Lloyd's of London Press Ltd., 1988.



## Executive Summary

This paper studies the links between government intervention and international competitiveness in the maritime transport services sector. The analysis is conducted with a special focus on the economic costs and benefits to Canada of further opening up trade in this sector through reduction and/or elimination of various forms of government intervention intended to, or resulting in, the promotion of national fleets.

In this paper, government intervention is divided into two different categories. One of them is comprised of the market access agenda on which the Negotiating Group on Maritime Transport Services (NGMTS) has focussed within the WTO framework (i.e., international shipping, auxiliary services and access to or use of port facilities). The second is made of other important elements of state intervention which affect a maritime carrier's international competitiveness, most notably fiscal incentives.

The paper's findings indicate that liberalization in the fields covered by the NGMTS are in Canada's interest since it would likely result in increased access by foreign vessels to international markets, thus strengthening competition and eventually leading to lower freight rates and better quality of service. As residents of a highly trade-dependent country, Canadians stand to benefit substantially from improvements in pricing and reliability of maritime transport services. Furthermore, as this liberalization would lead to cost reductions and improvements in service for shippers in many other countries – leading to greater efficiency, higher global economic activity and trade – demand for Canadian products would likely grow faster.

Such positive outcomes are all the more stronger considering that Canada is not a major carrier nation in the international maritime transport industry. In fact, Canada is overwhelmingly a consumer country: apart from transborder shipping to ports in the United States, Canadian registered vessels are practically absent from international trade.

Finally, with respect to the components of state intervention that were not on the NGMTS agenda, in particular fiscal incentives, this paper argues that it is not clear that Canada, as an overwhelmingly net consumer of international transport services, would benefit from an agreement that would rule them out. In fact, this paper shows that eliminating fiscal incentives would likely have a detrimental effect on Canada, at least in the scenario where Canada shows no intention of regaining an important domestic fleet involved in international trade. This is because fiscal incentives granted to foreign fleets tend to reduce the freight rates for Canadian consumers of international maritime transport services. This benefit must, however, be tempered

by the fact that these fiscal incentives provided by foreign countries create distortions within their economies which result in lower economic efficiency, slower growth, and thus potentially lower future demand for Canadian exports.

## Introduction

During the last few decades, the global maritime transport services sector, a large underlying factor in international trade, has witnessed an important surge in state intervention. This increased intervention, which led to complex regulatory frameworks, fleet subsidization and protectionism, has its roots in several factors, notably the developing countries' aspirations to build their national fleets in a post-colonial world, the OPEC-led 1973 oil crisis, and the reaction of traditional, developed, maritime countries to the rise of open-registry countries (or flags of convenience). The issue of the liberalization of maritime transport services is thus entangled in a complex web of state practices designed to promote national fleets either by granting a wide range of incentives or by limiting access by foreigners to their domestic markets.

Attempts to liberalize this sector were made both during the Canada-US Free Trade and the North American Free Trade negotiations. Their results were very modest, however, mainly because of strong opposition from the US maritime industry to any form of liberalization in this sector. Only one marginal gain was made during the NAFTA negotiations, i.e. that of a slightly enlarged market for Canadian ship repair companies made possible by the progressive elimination of tariffs on trade in goods.

On a more global scale, liberalization of this sector was addressed for the first time under the General Agreement on Tariffs and Trade (GATT)/ World Trade Organization (WTO) framework during the Uruguay Round, which was launched in 1986<sup>1</sup>. Unfortunately, negotiations proved unsuccessful. At the formal completion of the Round, in April 1994, all that participants could agree on was to pursue the negotiations (until no later than June 1996) under a newly-created Negotiating Group on Maritime Transport Services (NGMTS). The NGMTS received the mandate of pursuing negotiations to achieve commitments in international shipping, auxiliary services, and access to or use of port facilities.<sup>2</sup>

The NGMTS negotiations began in May 1994. Two years and seventeen meetings later, in June 1996, negotiations ended inconclusively again. Shortly after that, the US announced that

---

<sup>1</sup>The GATT's Uruguay Round was the first to address the ever growing issue of international trade in services on a multilateral and exhaustive basis. The completion of this round of negotiations led to the *General Agreement on Trade in Services* (GATS). Conducted under the auspices of the Group of Negotiations on Services (GNS), specifically constituted to address trade in services, negotiations were held on general commitments and disciplines applicable to all services, as well as on further sector-specific commitments, notably in the maritime transport services industry.

<sup>2</sup>OECD, *Maritime Transport 1995*, 1997 edition, Paris, 1997, p. 47.



it would not be tabling an offer of liberalization commitments<sup>3</sup>. Further negotiations are scheduled to recommence in the year 2000 as part of the next round of comprehensive service negotiations. In the meantime, participants in the NGMTS agreed to a "standstill" on measures that could improve their leverage in negotiations in future years.

This paper highlights that, although the issues discussed during the NGMTS negotiations are important elements in the process of providing a more level playing field for participants in international shipping, they are by no means sufficient. Another very important ingredient in providing a more level playing field would be an agreement on fiscal incentives which, in many cases plays an essential role in keeping shipping companies afloat<sup>4</sup>.

The outcome of negotiations in this area of subsidies will perhaps *eventually* be settled in the negotiations on subsidies in accordance with Article XV:1 of the WTO's General Agreement on Trade in Services (GATS) which provides for negotiations to begin no later than the year 2000 to develop disciplines on trade distorting subsidies. We say "eventually" because one should not expect rapid results from these negotiations as any investigation in subsidization of services will likely fuel a multitude of conceptual questions of a much more complex nature than that of the subsidization of goods.<sup>5</sup>

Whatever the amount of time it takes to come to a settlement on the subject, it is clear that the outcome of the negotiations on trade-distorting subsidies can potentially have an important impact on the state of the international maritime transport services industry. Thus, at this stage of the process it is of prime importance to understand the links between fiscal incentives – and more generally, all forms of state intervention – and international competitiveness in maritime transport. Contributing to this understanding is an important aim of this paper.

This paper uses the prism of the Canadian interest: as such, it analyses the different faces of government intervention in shipping with an eye for what is beneficial for Canada, considering its current policies with respect to international shipping.

---

<sup>3</sup>Thomas, J. and Meyer, M., *The New Rules of Global Trade: A Guide to the World Trade Organization*, Toronto, Carswell, 1997, p. 242.

<sup>4</sup>As this paper shows, fiscal incentives are particularly important because of the "footloose" character of shipping companies.

<sup>5</sup>Thomas, J. and Meyer, M., *op. cit.*, p. 225.

## Structure of the Paper

This paper has two chapters. Chapter I sets out the structure and characteristics of Canada's maritime transport services industry, focussing not only on the activities of the Canadian-flag<sup>6</sup> fleet, but also on those of the Canadian owners of ships registered abroad. To provide a better context, this description is supplemented by an overview of the importance of the global maritime transport services sector: its major actors, recent developments, as well commodities carried and major trading routes.

Chapter II explores a range of measures available to national governments to influence the pattern and character of trade in maritime transport services. It also discusses the distorting economic effects and the costs related to such measures which hamper the economic efficiency of the sector, with a special focus on measures affecting Canada's interest.

Finally, the conclusion summarizes the main findings and considers them in the context of Canada's maritime transport policy.

---

<sup>6</sup>In maritime transport, the flag of a vessel indicates the country of registry, from which it is a national subject to its laws. In many countries, the owner of the vessels does not have to be a national.



## **I: The Importance of Maritime Transport in Domestic and in World Trade**

After the Second World War, Canada began to progressively lose its major maritime country status. Today, nearly all of the country's waterborne trade with overseas countries is carried on foreign vessels, i.e., registered in foreign countries. The Canadian-flag fleet is virtually confined to domestic and transborder trade<sup>7</sup>(with the US). It should be noted, however, that stating that Canada's waterborne overseas trade is carried quasi-exclusively on foreign vessels is not tantamount to asserting that Canadians are not involved in this trade. In fact, Canadian companies operate very important deep-sea vessels; only, these are registered in countries where operating costs and levels of taxation are lower.

This chapter describes Canada's current participation in maritime transport and acts as a preamble, setting the basis for Chapter II, which is the core of this paper. Section 1.1 describes Canada's domestic fleet: its composition, merchandise carried, and major trading routes. Section 1.2 provides an overview of Canada's involvement in overseas trade through management of foreign-vessel controlled and/or owned by Canadian companies or subsidiaries of foreign companies established in Canada. Finally, to place Canada in the global maritime context, Section 1.3 concludes this chapter by providing an overview of the world merchant fleet: its major participants, merchandise carried and trading routes.

### **1.1 *Canada's domestically registered fleet***

Since the Canadian-flag fleet is virtually confined to domestic and transborder markets, its size is closely linked to that of its shares of these two markets. Domestically, the *Coasting Trade Act* restricts cabotage (i.e., domestic trade) to vessels registered in Canada. As a result, the Canadian-flag fleet's share of the domestic market is close to 100% (it is not a full 100% since the *Act* has certain exceptions allowing foreign presence in very limited circumstances). On the transborder trade front, Canada's share is approximately 55%, which reflects the fleet's competitiveness vis-à-vis the US fleet. Much of the activities of the Canadian-flag fleet is concentrated in the Great Lakes/Saint Lawrence area.

In 1997, Canada had 174 self-propelled vessels, totalling 2.4 million dwt, to serve these two markets<sup>8</sup>. The most important type of vessel was the dry bulk carrier, both in number (72 vessels registered in 1997) and in tonnage (1,953 thousands dwt). Dry bulk carriers were followed by: ferries with almost as many vessels (60), but a much smaller total tonnage (76 thousands dwt); tankers, with 20 vessels totalling 226 thousands dwt, and finally, sixteen general cargo vessels totalling 86 thousands dwt. In addition, the Canadian fleet of tugs and barges,

---

<sup>7</sup>In the case of Canada, overseas trade refers to any trade with a foreign country, other than the US.

<sup>8</sup>Vessels of 1,000 dwt or more.

according to the Canadian Transportation Agency, was made up of 253 tugs and 1,312 barges, totalling 1.5 million gross tons.<sup>9</sup> This fleet is very important to commerce on the West Coast.

In both aspects of its size – i.e., tonnage and number of vessels – the Canadian registered fleet is in decline, reflecting at least partly Canada's progressive withdrawal from international transport. Throughout the 1975-1997 period, the number of self-propelled vessels (excluding ferries), after reaching a peak of 216 in 1977, has been declining almost steadily since 1981, standing at 114 in 1997. As for the fleet's total tonnage, after having reached a high of 3.67 million dwt in 1984, it fell almost each year ever since, standing at 2.37 million dwt in 1997.

This decline in terms of tonnage and number of vessels is complemented by another trend: the impressive growth in the fleet's average size of vessels, which occurred as old ships were partly replaced by larger ones. This phenomenon is reflected in Figure 1 (next page) by a much more rapid decline in the number of vessels than in total tonnage. Indeed, average tonnage increased from 13.33 thousands dwt per vessel in 1975, to 20.82 thousands dwt in 1997. Most of this gain occurred in the 1975-1985 period.

### 1.1.1 *Domestic traffic*

Since 1993, Canadian domestic traffic has stabilized at around 50 million tonnes, after an important decline from 70 million tonnes in 1988. A significant factor that has contributed to this decline is the westward shift in the direction of commodities originating from Ontario and Western Canada. Many commodities (e.g., grain) which were previously carried mostly through the Great Lakes and the Saint Lawrence on Canadian vessels (and then transferred in Eastern ports for shipment across the Atlantic Ocean) are now being sent by rail to the port of Vancouver for shipment to Asian markets.

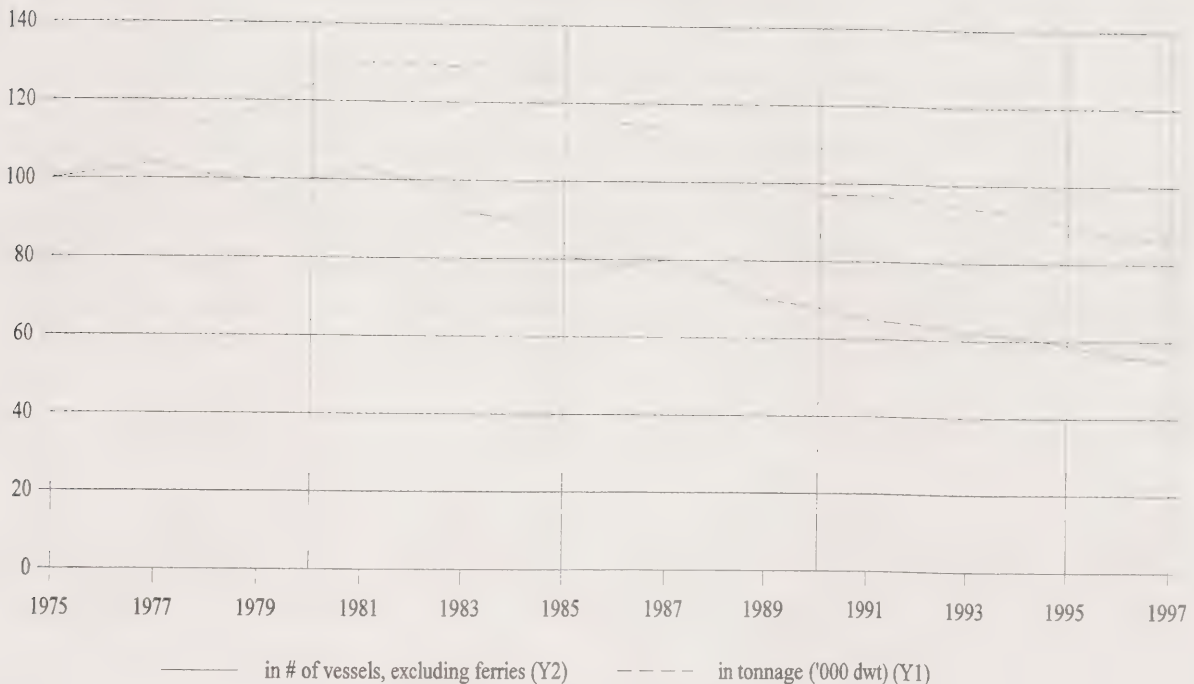
Still, the Great Lakes and Saint Lawrence Seaway remains the busiest maritime trading route, with 59.6% of all merchandise carried domestically originating from and/or destined to its ports in 1996. The Pacific Region came next with 29.6% of tonnage carried, followed by the Atlantic Region (10.8%). Most of this trade (all of it in the case of the Pacific) was intra-regional<sup>10</sup>.

---

<sup>9</sup>Transport Canada, *Annual Report 1997*, <http://www.tc.gc.ca>.

<sup>10</sup> *Ibid.*

Figure 1: The Canadian Registered Fleet, 1975-1997  
in Tonnage (left scale) and Number of Vessels, 1975=100



Source: Transport Canada, T-Facts (<http://www.tc.gc.ca>).

The mixture of commodities carried differs across the Canadian regions. In 1996, on the West Coast, major commodities loaded and unloaded (1996 data) included forest products (22.6 million tonnes), construction materials (4.7 million tonnes) and petroleum products (1.1 million tonnes). In the Great Lakes – i.e. all ports in Ontario –, construction materials (7.7 million tonnes), grains (7.4 million tonnes, down from 15.9 in 1987) and iron ore (5.5 million tonnes) were predominant. Finally, the main commodities of the Eastern region – i.e. all ports in Quebec and the Atlantic provinces, including the port of Churchill – consisted of petroleum products (12.3 million tonnes), iron ore (8.6 million tonnes) and grains (4.4 million tonnes).<sup>11</sup>

### 1.1.2 Transborder traffic

In 1996, the Canadian-flag fleet carried approximately 55% of Canada's maritime

<sup>11</sup>It is important to note that these data refer to loading and unloading of commodities. Since each commodity domestically carried is handled twice, total traffic is roughly half of what is mentioned for each region. *Ibid.*



merchandise trade with the United States. Total waterborne trade with the US reached a peak of 88.5 million tonnes in 1996, for a value of \$9.4 billion.<sup>12</sup> The importance and commodity mixture of transborder trade in each region are diverse.

### *Exports*

In 1996, exports were carried through two main trading corridors: the Atlantic and the Great Lakes. Of the 52.5 million tonnes of merchandise shipped to the US by the marine industry, 19.7 originated from Atlantic Canada, while 10.5 came from Great Lakes ports. Major commodities included petroleum products (13.0 million tonnes), iron ore (11.3 million tonnes), gypsum (5.5 million tonnes), stone/limestone (4.6 million tonnes), salt (3.5 million tonnes) and cement (3.2 million tonnes).

### *Imports*

In 1996, three quarters of the 36.1 million tonnes of imports from the US were sent via American Great Lakes ports. Those shipments were mostly (85%) unloaded in ports located in the Canadian Great Lakes or the Saint Lawrence. Imports consisted mostly of coal (11.6 million tonnes), iron ore (6.3 million tonnes), petroleum products (3.8 million tonnes), grain (3.5 million tonnes) and stone/limestone (3.5 million tonnes).<sup>13</sup>

## **1.2 *Canada's participation in international maritime transport through vessels registered abroad***

Many Canadian maritime transport companies are involved in overseas trade. However, since they mainly operate through subsidiaries incorporated and vessels registered abroad, it is not always easy to describe with precision the extent of Canadian participation in overseas maritime transport. Besides, how does one describe and assess participation? Is the simple ownership of shares sufficient, or is some form of effective control over a shipping company's operations required? If some form of effective control is deemed required, does a company need to own a vessel in order to control it?

Transport Canada, in its report entitled *Analysis of the Foreign-registered Fleet's Share in Canadian Merchant Shipping* (1997), proposes useful benchmarks to answer some of the above questions. The report identifies two broad types of Canadian participation in international trade via foreign-flag vessels: 1) control and ownership of foreign vessels by Canadian

---

<sup>12</sup>Statistics Canada, *Shipping in Canada 1996*, catalogue 54-205, and Transport Canada, *Annual Report 1997*, op. cit.

<sup>13</sup> *Ibid.*

companies and 2) management in Canada of foreign vessels owned by foreign companies. The two following sub-sections detail these two types of participation and provide an indication of their scope.

### **1.2.1 *Ownership and control of foreign registered vessels by Canadian companies***

This type of participation refers to vessels owned or controlled (i.e., chartered or managed) by Canadian companies (including subsidiaries incorporated abroad) for a minimum period of six months<sup>14</sup>. It gives us an indication of the importance of the international cargo carried with foreign-flag vessels by Canadian companies (and their subsidiaries abroad) since their tonnage hired over at least a six-month period can be considered as an approximation of the expected demand for their services.<sup>15</sup> It does not provide, however, an idea of the extent to which the ship management activities are carried out in Canada: much of this activity may in fact take place in subsidiaries abroad.

In 1996, Canadian companies and their subsidiaries abroad owned or controlled 136 foreign-flagged vessels with a total tonnage of 4.36 million dwt, nearly twice as much as the domestic fleet (2.4 million dwt).<sup>16</sup> The most important type of ships, in number as well as in tonnage, was the bulk carrier with 64 ships, totalling 2.16 dwt. Then came oil tankers with 589 thousands dwt and 8 vessels, followed by self unloaders with 541 thousands dwt and 11 vessels, and by container carriers with 455 thousands dwt and 11 vessels.

---

<sup>14</sup>Transport Canada (Marine Policy and Programs), *Analysis of the Foreign-Registered Fleet's Share in Canadian Merchant Shipping* (public version), March 1997. It should be noted that the report contains no explicit definition as to what is considered a Canadian company. Furthermore, for a subsidiary that is not wholly-owned by a parent company, the minimum level of ownership required by the Canadian parent company is not indicated. These imprecisions can nevertheless be considered as minor irritants only, because: i) the document appears to work under the reasonable assumption that a company is Canadian if its head office is located in Canada and its owner(s) or most of its shareholders are Canadian residents; ii) wholly-owned subsidiaries are the rule in the Canadian foreign-flag maritime transport sector.

<sup>15</sup>By setting the minimum charter period to six months, Transport Canada attempted to prevent excessive underestimation of the cargo carried under Canadian control (large quantities of goods can be shipped during that period) while avoiding to include single trip contracts over which the charterer has very limited control.

<sup>16</sup>Data for the Canadian controlled foreign-flagged fleet include vessels of less than 1,000 dwt, while the domestic fleet only includes vessels with tonnage higher than 1,000 dwt. This does not significantly affect the comparison as the vessels of less than 1,000 dwt are very few in the foreign-flagged fleet and do not significantly affect its total tonnage.

### 1.2.2 *Management of foreign registered vessels on behalf of foreign companies*

Some foreign shipping companies, taking advantage of Canada's tax-free regime at the corporate level for international shipping<sup>17</sup>, have established subsidiaries in Canada to manage certain aspects of their shipping operations. Some other companies specializing in the management of ships have established themselves or a subsidiary in Canada. The term "management" can mean several things. Transport Canada distinguishes between commercial, technical and crew management:

[...] commercial management consists in finding potential markets for ships and in providing estimates on the pros and cons of one or the other potential trip or charter party. Often, companies specialized in commercial management find the optimum contracts for the ships and take care of negotiating the contract. It is not uncommon for these firms to act as representatives of the owner and to take charge of negotiations, payments and collection of transportation costs.

The technical management of a ship consists mainly in ensuring that the owner's ship is properly equipped (roping, lubricants, tools, parts...), maintained in good condition and repaired when necessary. In sum, management companies are responsible for ensuring that nothing is missing on the ship for its proper operation. However, the technical management of a ship may occasionally entail much heavier responsibilities. For example, some firms may be responsible for purchases and accounting. They are thus in a good position to determine the costs of a given trip.

Crew management does not in fact give any control over the ship to the firm responsible for the crew. In general, companies are only responsible for ensuring that the ship's crew is qualified and for bringing them home at the appropriate time. In general, firms are not responsible only for the crew, but they provide this service to owners who request it.<sup>18</sup>

Unfortunately, it is very hard to determine what are the standard management contracts carried out by Canadian management companies as these are often kept secret.

A minimum of 69 vessels with a total tonnage of 6.16 million dwt were managed by 8 foreign companies established in Canada in 1996. The reason why this fleet's total tonnage exceeds by far Canada's domestic and foreign-flag fleet, despite the fewer ships that it comprises, is that these vessels are of more recent manufacture (therefore mostly of larger sizes) and that very few of them need to enter the St. Lawrence or the Great Lakes; consequently, they do not have special draft or dimensional requirements.<sup>19</sup>

---

<sup>17</sup>Chapter II provides further details.

<sup>18</sup>Transport Canada, *Analysis of the Foreign-registered Fleet's Share in Canadian Merchant Shipping* (1997), pp. 6-7.

<sup>19</sup>*Ibid.*, pp. 42-43.



### 1.3 *An overview of the world's seaborne trade and merchant marine fleet*

International cargo seaborne trade is constantly increasing. In 1996, it reached a record high of 4.76 billion tons, a 2.3% increase over 1995. Estimates also point towards a solid growth for 1997, with a 3.8% gain over 1996. In 1995, Canada's transborder and overseas trade represented 5.5% of the world's international seaborne trade, a percentage somewhat greater than Canada's share of the world's international trade in goods and services of 3.8% <sup>20</sup>.

To carry this volume of cargo, a world fleet totalling 758.2 million dwt was available in 1996. In terms of tonnage, the world fleet was mainly composed of bulk carriers (273 million dwt), oil tankers (271 million dwt) and general cargo carriers (105 dwt). Container vessels, although relatively minor players in terms of dwt (49 million dwt in 1996), represented the fastest growing segment of the fleet, with an increase of 11.2% in dead-weight tonnage over 1995. Furthermore, with container ships on order in 1995 representing almost 25% of the existing fleet, it is clear that significant growth prospects are anticipated for this component of marine transport.

#### 1.3.1 *Major commodities and trading routes*

Crude oil was by far the most important commodity carried, with 1 428 million tonnes in 1995. Other major commodities included coal (407 million tonnes), iron ore (400 million tonnes), oil products (380 million tonnes) and grain (198 million tonnes).<sup>21</sup>

Nearly half of traffic flows in world international maritime trade (measured in TEU) originates and/or is destined to Asia. Indeed, in 1995, the three most important trade flows were as follows: North America/Far East (22.9%), Intra-Asia (12.8%), and Europe/Far East (12.4%). Traffic flows between North America and Europe came next with 10.9% of world trade.<sup>22</sup>

#### 1.3.2 *Countries of registry*

Several trends have characterized the evolution of the world's market with respect to countries of registry, notably the rise of the open-registry countries and the growth of the developing countries' share of world trade carriage.

Also called "flags of convenience", open-registry countries offer favourable registry conditions such as low or no taxation, competitive manning and safety regulations, etc. A further

---

<sup>20</sup>United Nations Conference on Trade and Development (UNCTAD), *Review of Maritime Transport 1997* and Transport Canada, *Annual Report 1997*, *op. cit.*, and World Trade Organization (WTO), *WTO International Trade Annual Report*, vol 2.

<sup>21</sup>*Ibid.*

<sup>22</sup>OECD, *Maritime Transport 1995*, *op. cit.*

characteristic of "pure" open-registry countries is the fact that they are not important bases for shipping companies (parent companies are not located in the country), nor are they significant home countries for seafarers (demand far exceeds supply)<sup>23</sup>.

The rise of open-registry countries has been greatly accelerated by the tightening of the competitive environment which resulted from the 1973 oil crisis. Shipowners from traditional maritime countries (i.e., major maritime countries of the developed world) turned towards open-registry countries to survive in a ferociously oversupplied shipping market. Between 1973 and 1986, the developed (OECD) countries lost a 20% share of the world fleet to flags of convenience. Although the flagging out has somewhat slowed down since then, the importance of the open-registry countries has kept on growing. In 1996, their share of world tonnage was 357.9 millions dwt, i.e., 56.3% of the world fleet. The top five open-registry fleets in tonnage in 1996 were Panama (108.9 millions dwt), Liberia (92.7 millions dwt), Bahamas (35.4 millions dwt), Cyprus (33.1 millions dwt) and Malta (27.6 millions dwt).

### ***1.3.3 Ownership of the world fleet***

The fact that Canada is not a major player in the world's merchant marine trade is eloquently reflected by its absence from the UNCTAD list of the world's top 35 most important maritime countries (next page). This list presents the total deadweight tonnage as at 31 December 1996 of vessels both registered domestically and abroad for each of the 35 most important merchant marine countries. The level of concentration of the world's fleet is impressive: the five most significant countries, Greece, Japan, the United States, Norway and China represented half of the world's total tonnage. As for OECD members that made the list, their share of the world's tonnage was 65.8%. Non-OECD East Asian countries then followed with 18.85% of world tonnage.

---

<sup>23</sup>OECD, Directorate for Science, Technology and Industry - Maritime Transport Committee, "Treatment of Support Measures: Support Measures Granted by Member and Selected non-Member Countries to their Shipping and Shipping Related Industries - February 1998 Update, STI/DOT/MTC(98)9.

**Table 1: The 35 most important maritime countries and territories, as at 31 December 1996 a/**

| Country or territory of domicile <sup>b</sup> | Number of vessels          |              |        | Deadweight tonnage |              |             |                                     |                                    |
|---|----------------------------|--------------|--------|--------------------|--------------|-------------|-------------------------------------|------------------------------------|
|   | National flag <sup>c</sup> | Foreign flag | Total  | National flag      | Foreign flag | Total       | Foreign flag as percentage of total | Total as percentage of world total |
| Greece  | 912                        | 2 003        | 2 915  | 46 444 947         | 71 954 723   | 118 399 670 | 60.77                               | 17.41                              |
| Japan   | 922                        | 1 829        | 2 751  | 22 116 501         | 65 171 700   | 87 288 201  | 74.66                               | 12.84                              |
| United States                                 | 482                        | 732          | 1 214  | 13 134 699         | 35 994 699   | 49 129 398  | 73.27                               | 7.22                               |
| Norway  | 836                        | 568          | 1 404  | 28 127 282         | 20 781 990   | 48 909 272  | 42.49                               | 7.19                               |
| China   | 1 594                      | 378          | 1 972  | 23 162 264         | 13 095 430   | 36 257 694  | 36.12                               | 5.33                               |
| Hong Kong                                     | 104                        | 503          | 607    | 5 401 167          | 28 079 400   | 33 480 567  | 83.87                               | 4.92                               |
| South Korea                                   | 501                        | 303          | 804    | 10 253 709         | 12 869 037   | 23 122 746  | 55.66                               | 3.40                               |
| United Kingdom                                | 388                        | 510          | 898    | 5 269 713          | 15 875 697   | 21 145 410  | 75.08                               | 3.11                               |
| Germany                                       | 478                        | 984          | 1 462  | 6 140 698          | 11 918 853   | 18 059 551  | 66.00                               | 2.66                               |
| Russian Federation                            | 2 595                      | 239          | 2 834  | 12 231 787         | 5 113 585    | 17 345 372  | 29.48                               | 2.55                               |
| Taiwan  | 179                        | 254          | 433    | 7 577 719          | 7 534 148    | 15 111 867  | 49.86                               | 2.22                               |
| Sweden  | 203                        | 163          | 366    | 2 099 323          | 12 490 165   | 14 589 488  | 85.61                               | 2.15                               |
| Singapore                                     | 402                        | 252          | 654    | 8 876 995          | 5 544 741    | 14 421 736  | 38.45                               | 2.12                               |
| Denmark                                       | 439                        | 219          | 658    | 7 215 240          | 5 337 867    | 12 553 107  | 42.52                               | 1.85                               |
| India   | 381                        | 57           | 438    | 11 172 932         | 1 252 316    | 12 425 248  | 10.08                               | 1.83                               |
| Italy   | 452                        | 151          | 603    | 7 654 238          | 4 359 353    | 12 013 591  | 36.29                               | 1.77                               |
| Saudi Arabia                                  | 69                         | 58           | 127    | 1 078 603          | 9 749 334    | 10 827 937  | 90.04                               | 1.59                               |
| Brazil  | 205                        | 20           | 225    | 7 178 283          | 2 538 505    | 9 716 788   | 26.12                               | 1.43                               |
| Turkey  | 420                        | 23           | 443    | 8 997 546          | 107 859      | 9 105 405   | 1.18                                | 1.34                               |
| France  | 178                        | 105          | 283    | 4 313 260          | 3 446 166    | 7 759 426   | 44.41                               | 1.14                               |
| Iran  | 147                        | 6            | 153    | 6 133 908          | 206 284      | 6 340 192   | 3.25                                | 0.93                               |
| Netherlands                                   | 463                        | 199          | 662    | 3 597 792          | 2 196 115    | 5 793 907   | 37.90                               | 0.85                               |
| Switzerland                                   | 14                         | 191          | 205    | 618 880            | 4 549 769    | 5 168 649   | 88.03                               | 0.76                               |
| Ukraine                                       | 577                        | 64           | 641    | 3 587 740          | 1 261 689    | 4 849 429   | 26.02                               | 0.71                               |
| Philippines                                   | 321                        | 16           | 337    | 4 507 147          | 95 424       | 4 602 571   | 2.07                                | 0.68                               |
| Romania                                       | 250                        | 29           | 279    | 3 506 400          | 978 725      | 4 485 125   | 21.82                               | 0.66                               |
| Belgium                                       | 30                         | 140          | 170    | 148 155            | 4 105 155    | 4 253 310   | 96.52                               | 0.63                               |
| Indonesia                                     | 463                        | 86           | 549    | 3 060 844          | 1 154 412    | 4 215 256   | 27.39                               | 0.62                               |
| Thailand                                      | 233                        | 57           | 290    | 2 505 101          | 1 537 913    | 4 043 014   | 38.04                               | 0.59                               |
| Malaysia                                      | 182                        | 15           | 197    | 3 561 745          | 131 747      | 3 693 492   | 3.57                                | 0.54                               |
| Spain   | 127                        | 173          | 300    | 657 073            | 2 764 284    | 3 421 357   | 80.79                               | 0.50                               |
| Finland                                       | 115                        | 51           | 166    | 1 136 444          | 2 249 188    | 3 385 632   | 66.43                               | 0.50                               |
| Croatia                                       | 68                         | 106          | 174    | 696 043            | 2 591 991    | 3 288 034   | 78.83                               | 0.48                               |
| Australia                                     | 68                         | 29           | 97     | 2 807 519          | 479 388      | 3 286 907   | 14.58                               | 0.48                               |
| Kuwait  | 33                         | 6            | 39     | 2 863 725          | 351 028      | 3 214 753   | 10.92                               | 0.47                               |
| Total (35 countries)                          | 14 831                     | 10 519       | 25 350 | 277 835 422        | 357 868 680  | 635 704 102 | 56.29                               | 93.48                              |
| Percentage                                    | 58.5                       | 41.5         | 100    | 43.7               | 56.3         | 100         |                                     |                                    |
| World total                                   | 17 274                     | 11 480       | 28 754 | 303 417 789        | 376 626 659  | 680 044 448 | 55.38                               | 100.00                             |
| Percentage                                    | 60.1                       | 39.9         | 100    | 44.6               | 55.4         | 100         |                                     |                                    |

a/ Vessels of 1,000 grt and above, excluding the United States Reserve Fleet and the United States and Canada Great Lakes fleets.

b/ The country of domicile indicates where the controlling interest of the fleet is located, in terms of the parent company. In several cases, this has required certain judgements to be made. Thus, for instance, Greece is shown as the country of domicile with respect to vessels owned by a Greek owner with representative offices in New York, London and Piraeus, although the owner may be domiciled in the United States.

c/ Including vessels flying the national flag but registered in territorial dependencies or associated self-governing territories. For the United Kingdom, British flag vessels are included under the national flag, except for Hong Kong.

Source: reproduced from UNCTAD, *Review of Maritime Transport*, 1997.



## II: International Competitiveness and Government Intervention in the Maritime Sector

The size and international competitiveness of a national fleet are to an important extent determined by government policies. Illustrations of the key roles played by governments in this matter abound. For instance, thanks to the *Coasting Trade Act* which restricts domestic cargo and passenger traffic to Canadian-flag vessels, Canada's domestic fleet is guaranteed to be at least commensurate with the size of its domestic market. But, due also in part to its manning regulations which very generally require only nationals be accepted on board of domestically-flagged vessels, Canada's domestic fleet is limited in its activities to domestic and transborder – i.e. North American – trade<sup>24</sup>. Thus, government policies can promote or hamper – although not necessarily intentionally – the development of their maritime industries.

Generally, governments have an influence on their maritime services industries through means that can be grouped into three broad categories: fiscal incentives; crew members nationality requirements, manning and other safety regulations; and finally, flag discrimination. This chapter tries to provide some indications as to the extent to which these means are used in Canada and throughout the world's major maritime merchant countries. It also discusses their economic consequences, with a special focus on the impact on Canada's maritime competitive position, as well as on Canadian consumers of shipping services. Each type of fiscal incentive is the object of a section in this paper. But first, section 2.1 discusses the reasons why government intervention is so important to international competitiveness in this industry.

### 2.1 *Government intervention and international competitiveness: the links*

By reducing capital, labour and other operating costs, or by otherwise increasing after-tax profits, government intervention greatly influences localization decisions of shipowners involved in international maritime transport (i.e., decisions as to where to register their ships and incorporate subsidiaries). This is particularly so because of the "footloose" character of ship owning companies<sup>25</sup>. Indeed, shipowners can – and often do – move quickly from one country to another to take advantage of lower costs and better opportunities. These movements are facilitated by the fact that many countries offering tempting operating conditions have first-class infrastructures to host foreign vessels.

A very good illustration of the interplay between government intervention and localization

---

<sup>24</sup>Further details provided in section 2.3.

<sup>25</sup>A company is said to be "footloose" when its localization decisions are not dependent on the geographical proximity of inputs (e.g. natural resource, labour, energy) or markets. In international maritime shipping, capital – the vessel – is, by definition, extremely mobile. As for labour – the other important input – its price and availability can be said to be comparable across major internationally competitive maritime countries as most of them allow their fleets to be crewed with foreign seafarers.

decisions of shipowners was given by the shift of shipowners from developed countries to open-registry countries which followed the 1973 oil crisis. Faced with the stiffened competitive environment which ensued from the crisis<sup>26</sup>, many shipowners, in an effort to stay in business, took advantage of their footloose character and relocated to zero-tax countries<sup>27</sup>.

This flight to low or zero-tax<sup>28</sup> countries was not and still is not predominantly driven by the search for higher profits. Essentially, in most cases, it was driven by a fight for survival. Given the highly competitive nature of the industry, firms operating in zero-tax environments do not make super profits in the long run. Thus, since their after-tax, risk-adjusted, rate of return on capital corresponds to, but does not significantly exceed, what is necessary to keep them in business in zero-tax environments, shipowners with a "full" tax burden that operate in international markets are seriously handicapped<sup>29</sup>. In many cases, as we will see, they can only survive if they benefit from other forms of governmental assistance.

This does not mean that zero-tax environments are only comprised of open-registry countries. Faced with the flight of shipowners to zero-tax environments, developed countries who intended to remain participants in the post-1973 international shipping market have felt tremendous pressure to grant preferential fiscal treatment to their respective maritime industries. And many of them responded to this pressure. Today, almost every developed country participating in international maritime transport offers some form of preferential fiscal treatment. This is the subject of the next section.

---

<sup>26</sup>In the years prior to the crisis, shipowners from around the world were enlarging their fleets at a rapid pace, placing ship orders that corresponded to their expectations of a continued robust rate of world economic growth. As a result of the slowdown which ensued from the 1973 crisis, an oversized world fleet was now chasing a much lower-than-expected cargo volume.

<sup>27</sup>It should be noted that factors other than low taxation often played in explaining this flagging-out process: other conditions such as regulation, manning and safety requirements were important.

<sup>28</sup>Although often referred to as "zero-tax" environments, countries with no taxes on profits do still have a positive effective tax rate since most of them impose ship registration fees and often tonnage taxes which amount to modest taxation. Furthermore, one must consider that profits distributed to investors, as well as capital gains realized on the sale of shipping shares, are often subject to taxation in the investors' country of residence. See K. Knusden, "The economics of zero taxation of the world shipping industry", *Maritime Policy and Management*, vol. 25, no.2, April-June 1998.

<sup>29</sup>An argument often encountered in the economic literature is that zero-tax environments may not benefit firms operating within these environments in the long run. Many say that fiscal incentives are a poisoned gift because they may lead its beneficiaries to become less efficient compared to their competitors who must innovate and cut costs in order to remain competitive without government help. This argument is often valid and is frequently referred to as a key factor in explaining Canada's relative competitiveness in the Great Lakes market (Canada's domestic fleet is not significantly subsidized, while that of the US is). However, it is highly unlikely to be valid in the world international shipping market because of the sheer intensity of the competition already existing among firms located in zero-tax environments.



## 2.2 *Fiscal incentives*

### 2.2.1 *Definition*

As we have indicated in the introduction to this paper, the notion of "subsidies" (or, more generally, that of "fiscal incentives") has not yet been defined in the GATS.

This paper uses a definition that best suits the needs of the analysis of the links between government intervention and international competitiveness in maritime transport services.

By "fiscal incentives", this paper designates all the financial measures, i.e. tax concessions or subsidies, granted by a government *specifically* either to a company incorporated domestically and operating domestic or foreign-flag vessels, or to a company incorporated abroad that operates vessels registered domestically. More precisely, this study focusses on fiscal incentives that are likely to enhance a company's competitiveness in international maritime transport. Thus, incentives that are destined for a company operating exclusively within a country's domestic waters (e.g. most Canadian ferry companies) are not considered<sup>30</sup>. Such fiscal incentives are excluded from the analysis because the issue of allowing greater foreign competition in exclusively domestic maritime transport services is not an item on the liberalization agenda at this time, and is not likely to become one in the foreseeable future. Indeed, at the formal completion of the Uruguay Round, WTO Members decided to exclude this issue from further negotiations.<sup>31</sup>

Another case where an incentive would not be considered as a fiscal incentive in this paper is where a country's subsidies are available to any shipowner, whatever the flag of the vessel and the country of incorporation. That may be the case for instance in loan and interest subsidies for vessel acquisition.

Subsidies to companies that are involved in cargo handling and port services, but not in operating vessels, are not considered as fiscal incentives either (at least, as long as they do not

---

<sup>30</sup>Strictly speaking, one must admit that omitting to consider such fiscal incentives opens the door to situations where the state finances cross-subsidization, i.e. in the case where a firm operating strictly in domestic trade is owned by a parent company which also owns a company involved in international maritime transport. Cross-subsidization happens when a parent company, for instance, *Canadian Pacific*, finances one of its subsidiaries, say *CP Ships*, through some or all of its profits from another subsidiary, say *CP Hotels*.

The potential for financing cross-subsidization through fiscal incentives is not specific to the maritime sector. It is rather spread across all sectors of the economy and is determined by the structure of corporate ownership. Therefore, its existence is not in itself a sufficient reason to include financial incentives granted to strictly domestic maritime firms in our analysis.

<sup>31</sup>After failing to reach an agreement on maritime transport services during the Uruguay Round, Members agreed to resume talks after the formal completion of the Round, but cabotage was not to be a negotiating item as most maritime countries have cabotage laws and show little inclination to amend or abrogate them.



discriminate against foreign-flag vessels). However, fiscal incentives granted to third parties that provide direct financial relief strictly to domestic fleet members are considered (e.g. some subsidies to shipbuilding yards).

Finally, it is important to emphasize that, in order to be considered as fiscal incentives, the financial concessions granted by a government must be specifically destined to vessels-operating companies (or other maritime companies offering as a result better prices and/or services strictly to domestically registered vessels). As such, this definition focusses on the relevant preferential treatment that a government grants to its maritime industry over other types of industries. Therefore, *the fact that a country has a lower overall level of taxation does not mean it is providing fiscal incentives to marine carriers established in countries with higher overall levels of taxation*. Of course, the countries with lower overall levels of taxation are more attractive tax-wise, but this situation may not constitute an intentional effort to attract maritime service providers.

### ***2.2.2 A classification of fiscal incentives and an overview of their usage across the world***

A wide array of fiscal incentives are used by governments to improve their respective maritime transport industries' international competitiveness. This section provides a description of the different fiscal incentives offered by Canada and most of the major maritime countries. Each fiscal incentive is classified according to its direct impact on either capital cost, operating costs, or corporate tax burdens.

#### ***2.2.2.1 Fiscal incentives aimed at reducing capital costs***

Capital is the most expensive input in maritime transport. Depending on the characteristics of the ship and based on certain assumptions<sup>32</sup>, capital costs can represent anywhere from 47 to 61% of total costs. Capital costs are determined by the price of the ship, the rate of economic depreciation<sup>33</sup> and the level of the required after-tax rate of return on the capital employed (which in turn depends on the debt/equity ratio). These factors are interdependent: the higher the price of the ship, the higher must be the profits to keep the rate of return at the required level. Similarly, the faster a ship economically depreciates, the higher the annual capital costs and thus, the higher must be the profits for a given rate of return.

---

<sup>32</sup>Namely, these assumptions are that the residual value after nine years is 55% for bulk carriers and 50% for motor tankers; the real rate of interest on loans is 4%, pre-tax; the required rate of return on equity is 8%, pre-tax, and finally, that each vessel is employed in trades typical for its size. Total annual costs are comprised of return on equity (debt/equity ratio = 1), operating cost, depreciation, interest on loans. Knudsen, K., *op. cit.*

<sup>33</sup>The notion of economic depreciation is not to be confused with "fiscal depreciation". Economic depreciation refers to the real value of the ship lost on an annual basis. Fiscal depreciation refers to the annual amount of money that a company can declare as the equivalent of capital expenditures for income tax purposes.

Of course, governments can only have an impact on the price of the ship to reduce capital costs. The rate of depreciation, for its part, is determined by factors generally considered beyond governmental control.<sup>34</sup> As for corporate tax breaks (e.g. lower taxes on profits and accelerated fiscal depreciation) they affect only the level of profits, not capital costs; consequently, we consider that these fiscal incentives are aimed at reducing corporate tax burdens, not capital costs<sup>35</sup>.

Major fiscal incentives aimed at reducing capital costs consist mainly of shipbuilding subsidies, as well as loan and interest subsidies.

### *Shipbuilding subsidies*

Shipbuilding subsidies refer to monies directly granted to domestic shipyards. Such subsidies were traditionally used in developed countries to approximate building costs to those of foreign builders.

Today, many important shipbuilding countries (such as Japan, South Korea, China, Italy, Norway, France, Germany, Finland) still subsidize their domestic shipyards. Shipbuilding subsidies are excluded from the GATT's Agreement on Subsidies and Countervailing Measures.

Recently some progress in eliminating shipbuilding subsidies has been achieved at the OECD with the negotiation and signature by key shipbuilding nations (including Japan, South Korea, the European Union, Norway and the US) of an "Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry". If and when it is ratified by all signatory countries, this agreement – which covers 80% of the world's shipbuilding

---

<sup>34</sup>The rate of economic depreciation of a vessel is determined by a combination of factors, notably its useful life, the relative contribution of the vessel during each year of activity, and its residual value for the shipowner at the end of its useful life. As is the case for most capital goods, the relative contribution of a vessel is highest in its first years of operation (its technology is more state-of-the-art and repair and maintenance costs are lower). With respect to residual value, it is almost never zero: it depends on the characteristics of the vessels and the state of the market for such second-hand vessels. Even in the case that the vessel is not seaworthy any more, a market exists for vessels that are only good for demolition.

<sup>35</sup>Tax breaks affect the level of profits and thus, the after-tax rate of return on the capital employed. They do not, of course, affect the *required after-tax rate of return*, which, representing the remuneration of capital, is considered as a component of capital costs. This required rate of return is determined by the international financial market conditions, after adjustment for risks inherent to international maritime transport.

capacity – would provide for the elimination of direct shipbuilding subsidies within a period of three years.<sup>36</sup>

In Canada, only the government of Quebec has a shipyard subsidy program. This program can cover up to 40% of labour costs (to a maximum of 20% of total construction costs) of the first vessels, 30% of the second, 20% of the third and the fourth (and 0% for additional ships) of an order placed with a Quebec shipyard for a series of at least three vessels. No such subsidy has been granted so far for the construction of a vessel intended for commercial use in international transport.

It is also important to note that the agreement concluded under the auspices of the OECD would only provide for the elimination of direct subsidies; countries may still use other forms of assistance to help out their shipbuilders. They can, for instance, provide financing for research and development (e.g., ship design) and marketing activities in international markets on behalf of domestic shipbuilders. This is notably the strategy currently used by the American government. Indeed, the Maritime Administration (MARAD), under the sponsorship of the Department of Defense (DOD), has implemented a cost-shared research and development (R&D) project, called "MARITECH", to promote the reentry of the US shipbuilding industry into the international commercial markets. According to MARAD's May 1998 report to Congress, this joint initiative with DOD "[...] has generated 36 new commercial ship designs, supported technology transfer from shipyards in foreign countries, and engaged more than 200 industry participants from 40 states, the Commonwealth of Puerto Rico, and nine foreign countries."<sup>37</sup> MARITECH projects now total \$160 million in government and industry investment. As for marketing initiatives, MARAD co-sponsored international shipbuilding exhibitions and conferences.

Other countries providing state-financed R&D include Denmark, Australia, France, the Netherlands, Norway, Poland, Portugal, Turkey and the UK.<sup>38</sup>

---

<sup>36</sup>As ratification of this process in the US is still pending on Congress legislation enacting it, the Agreement is not in force at this time. Canada, for its part, had only an observer status during those negotiations (since it is not a major shipbuilding nation). Consequently, it is still waiting for ratification by members before deciding whether or not to join the agreement.

The EU, Norway, Japan and South Korea are currently considering to implement the Agreement without the US. South Korea, however, is still somewhat reluctant to move forward, arguing that it had ratified the agreement with the expectation that the US would follow suit. It also believes that this surge in interest in implementing the agreement is due to the fact that the Korean industry is currently extremely competitive, in part because of the weakness of the won. *Inside U.S. Trade*, "OECD Shipbuilding Agreement Could Go Ahead Without U.S. Role", Nov. 13, 1998.

<sup>37</sup>Maritime Administration (US Department of Transportation). *A Report to Congress on US Maritime Policy*, May 1998, <http://www.marad.dot.gov>.

<sup>38</sup> OECD. "Updated 1996 Inventory on Support Measures and Arrangements Provided to Shipping", July 1997, DSTI/SI/MTC(97)2.



A warning is in order at this point. Shipbuilding subsidies, although they reduce the price of the ship, and thus the capital costs for shipowners, may not necessarily represent fiscal incentives in the sense that is given to the term in this paper. First, let us recall that a subsidy granted to a shipyard specializing in the construction of vessels designed for inland or coastal trades cannot, according to our definition of fiscal incentives, be considered a subsidy because it is not likely to enhance a shipowners' competitiveness in international transport. Second, if a subsidy is granted to a shipyard without discrimination with respect to the nationality of its clients, it does not provide any tangible competitive advantage to the country's domestic maritime services providers and, as such, does not qualify as a fiscal incentive.

### *Loan and interest subsidies*

Government, or at least, publicly funded loans and interest subsidies for vessel acquisition or repairs, are granted by most major maritime countries. Governments can either directly grant loans representing a given percentage of the ship's value, or they can provide loan guarantees (which usually lead to lower interest rates on the commercial loan). They can also provide interest subsidies, whereby they pay a share of the loan's interest burden. No loan or interest subsidies specific to the maritime sector currently exists in Canada at the federal government level. However the Government of Nova Scotia has just adopted a program of construction loan guarantees of up to \$90 million, mainly to assist Halifax shipyards.

Loan and interest subsidies are usually granted on the condition that the vessel be built in domestic shipyards. Other conditions may apply, for instance that newly acquired vessels fly the domestic flag during the period of the loan, or that applicants be nationals of the country.

In some countries, as is the case in the US, no conditions are applied other than that the vessel be built domestically. Indeed, under Title XI of the *Merchant Marine Act* (1936), the US government extends its loan guarantees to eligible shipowners, foreign or domestic, "[...]for the purpose of financing or refinancing either US flag vessels or eligible export vessels constructed, reconstructed or reconditioned in US shipyards"<sup>39</sup>. Clearly in this case, the purpose of this subsidies program is not to help domestic flag carriers to compete internationally (since the program is available to US or foreign shipowners) but rather to promote activity in the US shipyards. As such, according to our definition, this program cannot be considered as a fiscal incentive for the purposes at hand. Japan, however, offers a similar program, but restricts it to Japanese shipowners; therefore, it must be considered as a fiscal incentive.

Other OECD countries offering loan and interests subsidies include Denmark, Finland, France, Italy, Norway, South Korea, Spain, Switzerland, Turkey and the UK.<sup>40</sup>

---

<sup>39</sup>MARAD, "Title XI Program", <http://marad.dot.gov/information/program.html>.

<sup>40</sup>OECD, *op. cit*, DSTI/SI/MTC(97)2.

### 2.2.2.2 *Fiscal incentives aimed at reducing operating costs*

Two major forms of fiscal incentives aimed at reducing operating costs can be identified: operating subsidies and preferential labour tax treatment.

#### *Operating subsidies*

Operating subsidies, often referred to (especially in the US) as operating differential subsidies, are intended to help domestically flagged vessels to remain internationally competitive, usually through annual subsidies. According to a survey conducted by the OECD with its membership and some other important maritime countries, only a few countries grant such subsidies: France (modernization grants), Italy, Germany (currently being phased-out) and the US (Box 1).<sup>41</sup> Operating subsidies clearly are incentives aimed at preserving a sizeable domestic fleet.

#### *Preferential labour tax treatment*

Labour costs differ substantially among countries, reflecting differences in wages, taxes and social security contributions, and manning regulations. Canada, as a rule, is a high maritime labour costs country, especially with respect to junior crew members (relative to say, the Philippines). Canadian senior officers, however, are not necessarily overpriced: many of them are hired on foreign ships where wages are often as high, if not higher.<sup>42</sup>

A government can enhance its country's competitiveness by reducing its shipowners' labour costs through reduction or exemption from taxes and/or social security contributions for seafarers.<sup>43</sup>

---

<sup>41</sup>Modernization subsidies are granted by France to encourage shipowners to keep their vessels afloat with technological improvements. Although, *per se*, they are capital subsidies, they can also be considered as operating subsidies to the extent that they have an impact on repair and maintenance costs. OECD, "Treatment of Support Measures: Support Measures Granted by Member and Selected non-Member Countries to their Shipping and Shipping Related Industries - February 1998 Update", Paris, doc. DSTI/DOT/MTC(98)9, March 1998.

<sup>42</sup>Jonathan Seymour, "A time for change: an internationally competitive Canadian flag? Pragmatic reform of the *Canada Shipping Act* is the answer", International Maritime Centre - Vancouver, 1998.

<sup>43</sup>With reduced taxes, shipowners can lower their crew members' total pay in the same proportion as that of the tax break in order to keep their net pay unchanged, and thus, *ceteris paribus*, employ the same number of qualified seafarers as before.

### Box 1: The US *Maritime Security Program*

Operating differential subsidies in the US are provided through the *Maritime Security Program* (title VI of the *Merchant Marine Act*). Like many US maritime initiatives, the official objective of the program is military: "to ensure that an active US merchant fleet, and the trained personnel needed to operate both active and reserve vessels, will be available to meet national security requirements for sealift capacity"<sup>44</sup>.

For fiscal years 1997 to 2005, the US Congress has voted a maximum of \$2.1 million annually in operating differential subsidies for each vessel that is eligible for subsidies under the conditions of the program (in summary, these conditions restrict subsidies to vessels engaged in international trade). At the time of publication of its report to Congress (May 1998), MARAD stated that 47 vessels were approved for the *Maritime Security Program*.

How has the program fared so far? Although one can say without many doubts that this program has contributed to keeping the US domestic fleet involved in international trade, some concerns remain regarding the efficiency (or at least the optimality) of the *Maritime Security Program*. Indeed, in its actual form, the program makes the granting of a subsidy conditional to a profitability test: "No such application [for subsidy] shall be approved by the Secretary of Transportation unless he determines that [...] the granting of the aid applied for is necessary to place the proposed operations of the vessel or vessels on a parity with those of foreign competitors".<sup>45</sup> With such a condition, many shipowners will not find it in their interest to cut costs to enhance their competitiveness since that will translate into lower subsidies.

Such preferential labour tax treatments are granted by many major maritime countries. Canada, for its part, does not grant any tax concessions to its seafarers (neither does the US).

---

<sup>44</sup>MARAD, *A Report to Congress on US Maritime Policy*, *op. cit.*  
<http://www.marad.dot.gov>.

<sup>45</sup>MARAD, *Merchant Marine Act* (1936), <http://www.marad.dot.gov>.



Preferential labour tax treatment can be delivered in many ways. They can be restricted to national seafarers on board domestic vessels and in international trade, or at the other extreme, be granted to all seafarers on board domestic vessels and all national seafarers on board domestic or foreign vessels. Finally, some dual registry countries may also grant preferential treatment to the crew of the foreign registry.<sup>46</sup>

The importance of labour tax concessions varies considerably from one country to another. Some countries provide full tax exemptions for seafarers, while others only grant reductions. For example, flags of convenience (i.e. open-registry countries) do not, as a rule, draw significant income taxes from seafarers; neither do Hong Kong and Singapore. Taiwan and Denmark also exempt their national seafarers from taxes, but only if they work on ships operating under its second register.<sup>47</sup> In Canada, Quebec offers a provincial income tax exemption for seafarers on board non Canadian-flag vessels (this however reveals to be of very little efficiency considering Canada's wage structure).

---

<sup>46</sup>A country is said to have a dual registry, or second-registry system when a ship can be registered domestically when it operates domestically and be registered in another country of which they become nationals – thus subject to its laws – for international trade purposes. Alternatively, this dual registry can be comprised of two separate registries: the domestic one – for vessels engaged in predominantly engaged in domestic trade – and the international one – for vessels engaged in international trade – each registry being subject to distinct regulatory conditions. Second registries are becoming increasingly popular. They either exist or are currently envisaged in many countries, including Norway, Denmark, France, Germany, Italy, Spain, South Korea, Brazil, Australia.

<sup>47</sup>OECD, *op. cit.*, DSTI/DOT/MTC(98)9 and OECD, *op. cit.*, DSTI/SI/MTC(97)2.

**Table 2: Income tax/wage cost (including social security contributions) exemptions or reductions in OECD and selected Non-member countries\***

|   |   |
|---|---|
| Exemptions for seafarers on national vessels  | <i>Cyprus, Hong Kong, Malta, Panama, Singapore, Taiwan**, Denmark**</i>       |
| Special deductions for seafarers on national or non national vessels                  | <i>Belgium, Korea, Norway, Poland</i>   |
| Special deductions exclusively for seafarers on board vessels on international routes | <i>Greece, Ireland, Turkey, United Kingdom, Canada (Quebec)****</i>           |
| Reimbursement of income tax and social fees to the shipping company                   | <i>Sweden, Netherlands</i>  |
| Different treatment for national and non-national seafarers                           | <i>Denmark***, Finland, Luxembourg, Portugal, Switzerland, United Kingdom</i> |

\* Cyprus, Hong Kong, Malta, Panama, Singapore and Taiwan.

\*\* On international register.

\*\*\* On non-international register.

\*\*\*\* Provincial income tax exemption for seafarers on board non Canadian-flag vessels.

Source: OECD, *op. cit.*, DSTI/DOT/MTC(97)2 and OECD, "Treatment of Support Measures: Support Measures Granted by Member and Selected and non-Member Countries to their Shipping and Shipping Related Industries, February 1998, DSTI/DOT/MTC(98)9.

### 2.2.2.3 *Fiscal incentives aimed at reducing corporate tax burdens*

Corporate income taxes can constitute a major cost for companies involved in international maritime transport. Indeed, firms operating in countries where taxation rates (on either profits or dividends) exceed 30% are seriously handicapped when competing with firms from countries where very few taxes are collected: in order to provide the same rate of return on capital employed, they must generate much higher pre-tax profits.

Many countries do not collect significant amounts of taxes from shipping income. Such countries include open-registry countries, as well as Singapore, Hong Kong, Greece and Norway, which only collect tonnage taxes usually amounting to less than a 1% corporate tax<sup>48</sup>. Other countries, such as Japan, the Netherlands, Australia and Belgium do not collect taxes from income earned abroad, i.e., on international voyages.<sup>49</sup> Canada, for its part, grants no particular corporate income tax incentives to its domestically-registered fleet. Nevertheless, in an effort to draw international ship management activity to the country, amendments have been brought to the *Income Tax Act* in 1991 to create a tax-free regime for branches of ship operating companies or ship management companies established in Canada (Box 2).

Many other features of a corporate fiscal regime can give an advantage to a country's fleet over that of another. For instance, in Canada, the provisions for fiscal depreciation are extremely advantageous: vessels can be fully depreciated in the space of three years. Although it is rather obvious that such a provision represents a fiscal advantage (as the economic life of the vessel is much greater than zero after three years), it is hard, as is very often the case with tax provisions, to conclude that it constitutes a fiscal incentive as defined in this paper. This is mainly due to the fact that much of the advantageous features of corporate tax regimes are not specific to shipping activities, but applicable to most sectors (for instance, vessels are not the only capital goods with much faster fiscal than economic depreciation).

---

<sup>48</sup>Some eligibility conditions apply for the tonnage tax in Norway.

<sup>49</sup>OECD, "Treatment of Support Measures", February 1998 Update, DSTI/DOT/MTC(98)9. This list is not exclusive as the survey does not cover all developed countries.



### Box 2: Canada's *International Maritime Centre (IMC)* Initiative

In 1984, the *Task Force on Deep-Sea Shipping* was created with the mandate "to evaluate changing conditions in the international shipping market and the possible need for measures to encourage the expansion of the Canadian deep-sea fleet"<sup>50</sup>. The report fell short of recommending measures to foster the development of a deep-sea fleet under the Canadian flag. Instead, it recommended that "the government create a fiscal environment conducive to the establishment and maintenance of international ship management activities in Canada"<sup>51</sup>. This led to amendments to the *Income Tax Act* referred to as the *International Maritime Centre amendments*, which came right in time for Vancouver to profit from an exodus of shipowners from Hong Kong wanting to relocate their management activities.

Basically, these amendments prepared the ground for the tax-free establishment of the "mind and management" of foreign ship management companies in Canada. Until 1990, a shipping company was considered a Canadian resident (for purposes of income tax) if its mind and management was found to be in Canada, in which case its income from international shipping was taxable in Canada. In 1991, an amendment was adopted to eliminate the "mind and management" test. From now on, the country of residency of a shipping company is its country of incorporation. As a result, a tax-free environment at the corporate level for international ship management activities in Canada was created.

According to *Lloyd's Shipping Economist*, this relocation is generally done through the direct establishment of a management company in Canada: "Establishing a management company seems to be the favoured approach, though a branch office would qualify for the same benefits. The owners themselves do not relocate, but everything is run from Vancouver through the Canadian registered agency/management company --shipping operations, maintenance, manning, supplies, accounts etc."<sup>52</sup>

Still according to *Lloyd's Shipping Economist*, more than 200 vessels are now controlled from Vancouver and more than 350 jobs depend on their existence, making the city the largest shipbroking centre in North America, after New York/Connecticut.<sup>53</sup>

### 2.2.3 *Economic implications for Canada*

As long as Canada remains overwhelmingly a net consumer of shipping services – i.e., as long as it does not significantly participate in international maritime transport – fiscal incentives provided by other countries to their shipping industries can be construed as beneficial to Canada. By reducing cost and required pre-tax rates of return on capital employed, fiscal incentives

<sup>50</sup>Task Force on Deep-Sea Shipping, *Report to the Minister of Transport*, Ottawa, 1985, p. iii.

<sup>51</sup>*Ibid.*, p. 55.

<sup>52</sup>*Lloyd's Shipping Economist*, September 1997, p. 9.

<sup>53</sup>*Ibid.*, p.9.

contribute to reducing freight rates, thereby benefiting the consumer of shipping services, i.e., the seller and/or the buyer for whom waterborne merchandise trade is done. Canadian exporters and importers thus benefit from lower freight rates.<sup>54</sup>

It can also be argued that these incentives promote Canada's international trade. Indeed, since they lower shipping rates, more exports and imports may be deemed profitable than what would otherwise be the case without such incentives. The importance of this trade-enhancing aspect of fiscal incentives is likely to be higher in maritime shipping than in any other merchandise transport sector, as ships usually carry merchandise of low value per unit of volume for which freight costs tend to represent a higher share of total production costs. However, this positive impact should be tempered by the fact that fiscal incentives create distortions within domestic economies providing them. These distortions will ultimately translate into lesser economic efficiency in those countries, lower economic growth prospects in the long run, and potentially lower demand for Canadian exports.

Another consequence usually stemming from fiscal incentives is the reduced competitiveness of its direct beneficiaries which come under less pressure to innovate and cut costs because of the "cushion" provided by fiscal incentives. However, as we have already indicated in this paper, this general observation is only of theoretical interest in the international shipping industry as the *norm* is to operate in an environment providing heavy fiscal incentives; therefore the state of the competition remains one of sheer intensity.

*Was the International Maritime Centre initiative a good deal for Canada?*

A cost/benefit analysis of the IMC initiative would probably conclude that it brought some economic benefits without costing much to Canadians. First, the initiative did not entail a significant loss of fiscal revenues to the Canadian treasury since the type of activity brought to Canada by this initiative was very marginal before its implementation. Had this activity been more important, the analysis would have been more complicated.<sup>55</sup>

---

<sup>54</sup>We will not discuss the issue of who, of the buyer or the seller, benefits from the lower freight rates. This question is empirical and depends notably on the interplay of supply and demand elasticities of the merchandises carried. Furthermore, Canadians are both buyers and sellers: thus, notwithstanding who gains the most from lower rates, Canada as a whole wins.

<sup>55</sup>If that would have been the case, the analysis should have notably taken into account the costs of lost revenues. A government who wishes to keep its revenues unchanged after granting tax concessions to existing companies must increase taxes elsewhere in the economy. As marginal increases in taxes have distorting effects on the decisions of producers and consumers, the economic cost to society of an additional dollar in taxes is not zero. Knusden points out that in the US, the additional cost to society of the extra revenue of US \$1 is US \$0.30, a fact which has the implication that "[...] every time one dollar is spent by the public sector, the purpose of the outlay should, in principle, command a utility of at least US \$1.30" (*op. cit.*, p.50).

The fact that the initiative was not costly is not sufficient in itself, however, to demonstrate that it was a good deal for Canadians: it must also be demonstrated that the initiative was a key determinant in bringing the activity to Canada, i.e., that it was a conducive localization factor. This would appear to be the case, considering the impressive influx of businesses that followed its implementation, and the previous relative absence of this type of business. This influx led to job creation in a high knowledge intensity sector, as well as growth in maritime infrastructure and expertise in shipbroking. All this at comparatively low cost, if any.

### **2.3 *Crew members nationality requirements, manning and other safety regulations***

This category of government intervention brings together the two most important types of internationally uncompetitive government regulations which do not involve fiscal concessions and whose objective is not to undermine access to Canadian shipping markets by foreign fleets (i.e. regulations which do not entail flag discrimination). Their purpose is either to promote safety at sea and environmental protection, or to comply with Canadian laws, such as the *Immigration Act*. As these measures are not aimed at limiting access by foreigners to international cargo transport, we will focus on the measures existing in Canada.

#### **2.3.1 *Crew members nationality requirements***

Most important registries allow that at least a significant proportion of crew members on board their vessels be non-residents, as long as they have training certificates deemed equivalent to their own. In Canada, the *Canada Shipping Act* states that Canadian vessels can only be crewed with Canadian residents<sup>56</sup>. As is the case with most crew members coming from developed countries, Canadian seafarers (except senior officers) are much more expensive than those coming say, from the Philippines. As a result, manning costs for Canadian vessels are internationally uncompetitive.

#### **2.3.2 *Manning and other safety regulations***

The *Canada Shipping Act* regulates the seaworthiness and the security practices to be adopted on Canadian vessels. Its provisions are intended to ensure that ships are properly manned (both in terms of number of seafarers and of their qualifications) and that vessels respect safety requirements (seaworthiness of vessels and availability of proper safety equipment). In Canada,

---

<sup>56</sup>In fact, the *Canada Shipping Act* does not directly forbid non-residents from working on Canadian vessels. What it states is that every seafarer on Canadian vessels must hold a Canadian certificate which, in turn, is only granted to Canadian residents. Moreover, even if non-residents could obtain Canadian certificates, Canada's *Immigration Act* would still require that equally qualified Canadian seafarers be chosen first to fill available jobs before that foreign seafarers can work on vessels predominantly engaged in domestic trade.



some requirements exceed what is required by international agreements. The result is that a Canadian vessel operating, say, on the Halifax-New York trading route must comply with the *Canada Shipping Act*, while a foreign-flag vessel will be allowed to travel in the Canadian portion of this route as long as it minimally respects international requirements.

The cost of safety practices is substantial. The OECD has estimated that for a 40 000 dwt tanker built in 1990, the daily running cost of maintaining top safety conditions is around \$US 9 500, while good practices cost \$US 4 850 and standard practices (compliance with basic standards of safety) cost \$US 3 750. If we consider as an illustration that the *Canada Shipping Act* requirements correspond to good practices, there is a daily difference of \$US 1 100<sup>57</sup>. Although no clear indication is available as to the difference between the costs of Canadian and international requirements, the numbers shown above indicate that differences in safety requirements can be expensive.

### 2.3.3 *Economic implications for Canada*

We have seen in this section that crew members' nationality, manning and other safety requirements unquestionably entail additional costs for Canadian-flag vessels shipowners. Of course, this translates into higher freight rates than would otherwise be the case if flexible manning were allowed and lower safety standards adopted. Consumers of goods carried by those vessels (which include many Canadian exporters) ultimately bear the price of these requirements. That being said, it is clear that Canadians enjoy substantial benefits from their existence, notably in terms of improved safety at sea, lower environmental hazards, and employment for Canadians seafarers. The analysis of the costs and benefits of the regulations mentioned in this section is a matter of public policy to be decided by Canadians.

It should be noted, however, that these regulations do not have a significant impact on providing safety at sea and protecting the environment with respect to Canada's overseas trade, which is being carried on foreign-flagged vessels.

Moreover, it can also be argued that, by contributing to the lack of international competitiveness of Canada's fleet, these regulations play a role in limiting employment opportunities for Canadian seafarers in overseas trade. If mixed manning (foreigners and Canadians) were allowed on a newly created Canadian second registry (elaborated and supported in a manner that would make it competitive in international trade), more employment opportunities would probably be available for Canadian seafarers. Of course, this would be subjected to the condition that Canada's currently available maritime jobs would be protected by limiting the activities of this register to overseas trade.

---

<sup>57</sup>OECD, "Competitive Advantages Obtained by Some Shipowners as a Result of Non-Observance of Applicable International Rules and Standards", 1996, OECD/GD(96)4.

## 2.4 *Flag discrimination*

This last category of government intervention comprises mostly the kinds of measures aimed at restricting access by foreigners to a country's trade that were on the table during the NGMTS negotiations. They consist mainly of reservation of cargo to domestically-flagged vessels or failure to provide "national treatment" to foreign competitors. This can be done through several means, notably, cargo-sharing agreements and cargo preference policies; restrictions to access to port and auxiliary services, and restrictions to multi-modal services.

### 2.4.1 *Cargo sharing agreements and cargo preference policies*

Cargo sharing agreements and cargo preference policies aim at reserving some of a country's maritime merchandise trade to its domestic fleet. These reservations can apply to cabotage or international cargo trade.

Most countries reserve cabotage trade for their domestic fleets (notable exceptions include the United Kingdom and Norway). Although such a reservation is clearly a limitation to market access, this topic has been dropped from the negotiating agenda of the NGTMS since there was very little interest from member countries in opening up this particular trade to foreign competition.

With respect to international cargo reservations, these can be conducted in accordance with multilateral or bilateral agreements, or unilateral decisions.

#### *Multilateral agreements*

The UNCTAD<sup>58</sup>'s *Convention on a Code of Conduct for Liner Conferences* is a cargo-sharing sch0:40:20" formula: 40 % of the liner conference cargo is reserved to each national carrier from both trading parties, and 20% to third country carriers<sup>59</sup>. Although many important European countries (France, Germany, Italy, Sweden, the UK are notable examples<sup>60</sup>) are

---

<sup>58</sup>United Nations Conference on Trade and Development.

<sup>59</sup>Liner shipping is defined as regular or scheduled operations of vessels, as opposed to vessels chartered for a specific period of time. Liner conferences refer to groups of ocean carriers providing liner services on a common trade route with internally agreed upon freight rates and/or conditions of service. Most countries exclude conference from the field of application of their competition laws, recognizing the conferences' international nature and the fact that they are somewhat constrained in their price-setting ambitions by the presence of non-conference competition. In Canada, conference are protected by the *Shipping Conferences Exemption Act*.

<sup>60</sup>These European countries have signed the code of conduct, albeit under what is termed the "Brussels Package" which states that the UNCTAD provisions will not apply to trade between EU and other OECD members. Lin Sien, C. and Trace, K., "Trade and Investment in Shipping Services", in *Pacific Trade in Services* (ed. By L. Castle and C. Findlay), Sydney, Allen & Unwin, 1988, p. 141.

signatories to it, this code is largely an initiative from the less developed countries to increase their share of world shipping.<sup>61</sup> In 1996, the code had 78 contracting parties and 5 signatories subject to agreement.<sup>62</sup> Neither the US nor Canada are signatories to this agreement.

According to the WTO, despite its important number of signatories, this cargo sharing arrangement has produced very little results; the Code was only implemented on trade between Western Europe and West Africa, i.e. 3% of world liner trade. Recently, the EU's competition directorate dissolved the conference concerned "on the grounds of abuse of dominant position towards outsiders".<sup>63</sup>

### *Bilateral agreements*

A substantial limitation – albeit of eroding importance<sup>64</sup> – to market access consists of bilateral agreements containing provisions for cargo-sharing. Many countries have at least one cargo-sharing agreement signed with another country. In the case of developed countries, these agreements are mostly signed with some often neighbouring less developed countries. Canada has so far signed only one bilateral agreement, namely with the People's Republic of China. However, contrary to the one concluded between the US and China, Canada's agreement contains no cargo-sharing provision; it focusses principally on securing market access and most-favoured nation status. The US-China agreement provides for at least a one-third share of cargo for each country<sup>65</sup>.

Brazil, a signatory of the UNCTAD code of conduct, provides an example of a country that considerably limits access to third party carriers for its cargo trade, with bilateral agreements providing for 50/50 sharing with neighbouring Argentina, Chile, Peru, and Uruguay (among other countries)<sup>66</sup>. Many Asian countries also have bilateral agreements, in addition to their memberships in the code of conduct.

### *Unilateral measures*

It is the policy of many countries to reserve a portion of their international trade to their

---

<sup>61</sup>*Ibid.*, p.140.

<sup>62</sup> OECD, *Maritime Transport 1995*, *op. cit.*, p. 52.

<sup>63</sup> World Trade Organization, *op. cit.*, doc. S/C/W/62.

<sup>64</sup>*Ibid.*

<sup>65</sup>MARAD, *Maritime Subsidies*, *op. cit.*,

<sup>66</sup>OECD, "Existing Impediments to Maritime and Multimodal Trade in Selected Non-OECD Countries", doc. DSTI/STI/MTC(97)20.



domestic fleet. This is often done through reservation for the domestic fleet of a certain percentage of general cargo and/or of cargo directly under government control<sup>67</sup>. Some countries may also rule that oil or other products must be partly or wholly carried on national vessels<sup>68</sup>. Canada has no cargo reservation policies.

The US, for its part, does have such reservations for government cargo. Indeed, according to its cargo preference laws, a certain percentage of its state-owned or financed cargo must be carried on nationally-flagged vessels. The *Merchant Marine Act* of 1936, as amended by the *Cargo Preference Act* of 1954, generally requires that 50 % of any US government-controlled waterborne cargo be shipped on privately owned US flag vessels. For foreign food aid, this percentage is 75%. As for military supplies, the *Cargo Preference Act* of 1904 states that they must only be carried on US-flagged vessels.<sup>69</sup>

Another form of restriction that should be mentioned is the EU's restriction on inland river transport of international cargoes. One thinks in particular here of the Revised Convention for the Navigation on the Rhine, which reserves transportation between two points on selected waterways for nationals of the contracting states of the Convention or from the EU.<sup>70</sup>

#### 2.4.2 *Restrictions to access to port and auxiliary services*

Ports services include pilotage; towing and tug assistance; provisioning, fuelling and watering; garbage collecting and ballast waste disposal; port captain's services; navigation aids; shore-based operational services essential to ship operations; emergency repair facilities; anchorage, berth and berthing services; and marine surveys and classification societies for the purpose of providing accurate documentation and certification of cargo and vessels. Auxiliary services, for their part, are comprised of maritime cargo handling services; storage and warehousing services; custom clearance services; container station and depot services; maritime

---

<sup>67</sup>Lin Sien, C. and Trace, K., *op. cit.*, p. 140.

<sup>68</sup>Lately, the US, which usually does not impose that requirement for the transportation of oil, has created some controversy over a bill which made its way through the Congress to allow the export of Alaskan oil for the first time in 22 years on the condition that it be carried on US-flagged vessels. This, argued the participants to the NGMTS negotiations, violated the "standstill" to which they had all agreed while the negotiations were ongoing. According to this "standstill", participants were not to adopt any measure that could increase their leverage during the negotiations. The US argued for its part that Alaskan oil had not been carried by foreigners over the last 22 years (since the 1973 oil crisis) and that this was not going to change under their proposed legislation. The bill, with its controversial provision, is now in force. Thomas, J. and Meyer, M., *op. cit.*, pp. 241-242.

<sup>69</sup>US Bureau of Transportation Statistics, *Maritime Industry: Cargo Preference Laws -- Estimated Costs and Effects*, Report to Congressional Requesters, p. 4, <http://www.bts.gov/ntl/DOCS/rc9534.html>.

<sup>70</sup>U.S. International Trade Commission, *Recent Trends in U.S. Services Trade: 1997 Annual Report*, investigation no. 332-345, publication 3041, Washington D.C., May 1997

agency services including marketing and sales of maritime transport and related services; and freight forwarding services.<sup>71</sup>

Flag discrimination in the delivery of these services is said to exist notably when foreign-flagged vessels have a lesser access to such services, either through a physical restriction on access or through a discriminatory pricing policy. For instance, among OECD countries, Japan, South Korea, Mexico, Norway, Poland, Turkey and the US deny access to some of their ports or give limited access to foreigners.<sup>72</sup> With respect to discriminatory pricing, Japan provides a good example. The Japan Harbor Transportation Association (JHTA), which runs waterfront services, control which stevedores and longshoremen work at which berth, thus eliminating competition among them. However, this control applies only to foreigners since Japanese carriers have their own terminals and are allowed to take care of their stevedoring operations by themselves. As a result, a non-domestic shipping company will pay around \$100 U.S. more to unload a 20-foot container. Considering that most container ships enter Japanese ports with around 2 000 to 4 000 such containers, this price difference is enormous.<sup>73</sup>

The US case is very interesting. Under the *Foreign Shipping Practices Act* (1988), the *Merchant Marine Act* (1920), and the *Shipping Act* (1984), the Federal Maritime Commission (FMC), an independent agency responsible for the regulation of shipping in the foreign trades of the US, may impose countermeasures that restrict or deny access to some countries' foreign vessels, or impose financial penalties when they call at US ports if it judges that these countries have "unfair or unfavourable practices which affect U.S. shipping or U.S. carriers in international commerce"<sup>74</sup>. This power exercised by the FMC, although defensive by nature, has no institutional checks-and-balance mechanism to ensure that it does not fall in the protectionist trap, i.e. that it does not protect the US from foreign competition with questionable justification.

### 2.4.3 *Restrictions to the establishment of multimodal services*

With the increasing importance of containerized cargo that can be easily loaded and unloaded on trains, trucks and ships, the cost and time saving ability of a shipping firm to transport cargo from its origin to its destination point using a single bill of lading<sup>75</sup> is becoming a

---

<sup>71</sup>List provided by the OECD, *op.cit.*, doc DSTI/SI/MTC(97)2.

<sup>72</sup>*Ibid.*

<sup>73</sup>Budwick, P., "A Tilted Port Policy", *Journal of Commerce*, October 30, 1996.

<sup>74</sup>Federal Maritime Commission, <http://www.fmc.gov>.

<sup>75</sup>The bill of lading is the equivalent of a transport contract giving particulars about the shipment. It performs two functions: to serve as a receipt for goods shipped and delivered by the carrier, and to serve as a certificate of title for the merchandise shipped. See Abrahamsson, B., *International Ocean Shipping: Current Concepts and Principles*, Boulder (Colorado), Westview Press, 1980. p.83 ff.

determinant of increasing importance to its competitiveness. Thus, the right to establish a land transportation subsidiary (or at least to freely contract with domestic land transportation carriers) for the purpose of operating multimodal operations becomes of prime importance for marine carriers involved in international trade.

Unfortunately, this permission is not granted by all trading partners: some countries simply forbid the establishment of such subsidiaries; others forces them to operate through Joint Venture Corporations, often with a cap on foreign equity below 50%.

#### **2.4.4 *Economic implications for Canada***

As flag discrimination measures share the common feature of limiting foreign competition by reducing or eliminating market access, they almost inevitably entail higher freight rates and a lesser quality of services. Canada, as an overwhelmingly net consumer country, is adversely affected by flag discrimination.

This negative impact of flag discrimination is greatest in the case of the most radical expressions of these measures, i.e., cargo sharing arrangements and cargo preference policies. Indeed, the cumulative impact of the entry by many countries into cargo-sharing agreements and the unilateral adoption of cargo preference policies is twofold: i) to reduce competition on the trading route concerned, thus potentially allowing freight rates to increase; and, ii) to reduce third-country access to foreign trade, thus limiting opportunities to benefit from economies of scale related to operating on a trading route involving more than two countries<sup>76</sup>. As for Canadian shipowners involved in overseas trade, they may be negatively affected by such agreements if they are barred from the markets of contracting parties to such an agreement, i.e., in cases such as where their ships are registered in countries which are not signatories to relevant agreement..

Cargo preference policies and agreements usually reveal themselves to be extremely expensive, particularly if they are applied to protect countries with fleets that are not internationally competitive (it is of course usually those countries who adopt such measures). In the case of the United States, the Bureau of Transportation Statistics has estimated that its cargo preference laws (described above) have cost them, over the 1989-1993 period, an estimated US \$578 million per fiscal year in excess of what it would have cost had they used competitively priced foreign services.<sup>77</sup> What's more, in 1992, 96% of American international maritime trade

---

<sup>76</sup>Indeed, as Lin Sien and Trace have observed: "The potential danger arising from the adoption of cargo reservation lies in the loss of efficiency which may follow the employment of smaller and less sophisticated vessels as multilateral trades are split into several bilateral trades." Lin Sien, C. and Trace, K., *op. cit.*, p. 141.

<sup>77</sup>Bureau of Transportation Statistics, *op. cit.* The US\$578 million figure refers to preference laws, not to cabotage; it thus excludes domestic transport.



was carried on foreign-flag vessels.<sup>78</sup> Of the four percent left for domestic vessels, only a fraction was transported under cargo preference laws.

---

<sup>78</sup> Canada-US maritime traffic is included in this figure.

## Conclusion

Through its analysis of the links between government intervention and international competitiveness in maritime transport services, this paper has highlighted the fact that the lack of competitiveness of Canada's domestic fleet can largely be explained by Canada's maritime regulations, as well as by the very low level of state-funded support (at least relative to major maritime countries). Indeed, Canada has made the policy choice to not support its domestic fleet in international transport to the same extent that some major developed maritime countries do. Instead, Canada has accepted to become an overwhelmingly net consumer of international maritime transport services.

In this context, fiscal incentives granted by other countries to their national fleets have been construed in this paper – with some reservations – as beneficial to Canadians. This is due to the fact that Canada's fleet is not very active in international trade and Canadians benefit from lower freight rates. Canada has most likely very little to gain from pursuing strong disciplines on subsidies to maritime transport services.

This paper has also highlighted the fact that the liberalization agenda of the WTO's NGMTS (international shipping, auxiliary services and access to or use of port facilities) would be beneficial to Canada if brought to a positive conclusion. Canadians would benefit from any progress on the NGMTS agenda (which promotes market access and stronger competition in international shipping) through lower freight rates and better quality of services.

One final observation: the analysis expounded throughout this paper would be somewhat different if Canada wanted to regain its major maritime country status. Of course, Canada would still most probably benefit from opening up trade in maritime transport services under the NGMTS agenda as it would provide better market access for its vessels. However, fiscal incentives granted to foreign vessels would likely entail additional costs to the Canadian treasury as Canada would probably also have to provide fiscal incentives (among other things) to its domestic fleet to ensure its international competitiveness. Although fiscal incentives granted to foreign fleets would still provide benefits to Canadian consumers of maritime transport services, these would at least be partly offset by the required fiscal concessions to support the Canadian fleet in international transport. Such fiscal concessions, apart from creating hazardous precedents in Canada's tax policy, would also create distortions in the Canadian economy, as many inputs would be drawn from more productive activities in order to take advantage of the tax concessions offered to Canada's maritime industry.

Certainly, further research on the feasibility and costs of rebuilding Canada's competitiveness in international shipping is required before one can make recommendations as to which, of the current situation or that of a strong Canadian fleet (through the creation, say, of an international registry), is the most beneficial to Canadians.

### Bibliography

Abrahamsson, B.J., *International Ocean Shipping: Current Concepts and Principles*, Boulder (Colorado), Westview Press, 1980.

Bergantino, A. And Marlow, P., "Factors Influencing the Choice of Flag: Empirical Evidence", *Maritime Policy and Management*, vol. 25, no. 2, April-June 1998.

Beth, H.L., *Economics of Regulation in Shipping*, Bremen, Institute of Shipping Economics, 1984.

Brooks, M. R., *Issues in Maritime Transport*, Halifax, Centre for International Business Studies (monograph series), 1989.

Budwick, P., "A Tilted Port Policy", *Journal of Commerce*, October 30, 1996.

Castle, L. and Findlay, C. (ed.), *Pacific Trade in Services*, Sydney (Aust.), Allen & Unwin, 1988.

External Affairs and International Trade Canada (G.K. Sletmo and S. Holste), "The Canadian Shipping Conferences Exemption Act: Issues and Roles for Shippers and Shipping Conferences", Ottawa, August 1991.

Federal Maritime Commission, "What We Do", <http://www.fmc.gov>.

Heaver, T. D., *National Flag Shipping: An Analysis of Canadian Policy Proposals*, Centre for Transportation Studies (University of British Columbia), 1982.

*Inside U.S. Trade*, "OECD Shipbuilding Agreement Could Go Ahead Without the U.S. Role", Nov. 13, 1998.

Knusden, K., "The Economics of Zero Taxation of the World Shipping Industry", *Maritime Policy and Management*, vol. 25, no. 2, April-June 1998.

*Lloyd's Shipping Economist*, "CP Ships Finds a New Dimension", December 1997.

*Lloyd's Shipping Economist*, "The New Centre of Maritime Excellence?", September 1997.

Organisation for Economic Co-Operation and Development (OECD), "Competitive Advantages Obtained by Some Shipowners As a Result of Non-Observance of Applicable International Rules and Standards", Paris, doc. OECD/GD(96)4, 1996.

\_\_\_\_\_, "Treatment of Support Measures: Updated 1996 Inventory on Support Measures and Arrangements Provided to Shipping", Paris, doc. DSTI/SI/MTC(97)2, Jul. 1997.



\_\_\_\_\_, "Conclusions du Comité des transports maritimes sur le renforcement de la compatibilité des politiques de la concurrence dans le transport maritime international de lignes régulières, y compris le transport multimodal comportant un parcours maritime", Paris, doc. DSTI/SI/MTC(98)1, Jan. 1998.

\_\_\_\_\_, "Treatment of Support Measures: Support Measures Granted by Member and Selected non-Member Countries to their Shipping and Shipping Related Industries - February 1998 Update", Paris, doc. DSTI/DOT/MTC(98)9, Mar. 1998.

\_\_\_\_\_, "Existing Impediments to Maritime and Multimodal Trade in Selected Non-OECD Countries", Paris, doc. DSTI/SI/MTC(97)20, Oct. 1997.

\_\_\_\_\_, *Maritime Transport 1995*, 1997 edition, Paris, 1997.

Schrier, E. and *al.*, *Outlook for the Liberalisation of Maritime Transport*, London, Trade Policy Research Centre, 1984.

Seymour, Jonathan, "A Time for Change: An Internationally Competitive Canadian Flag? Pragmatic Reform of the Canada Shipping Act Is the Answer", [reference and date unknown]

Statistics Canada, *Shipping in Canada 1995*, cat. 54-205-XPB, 1997.

Sullivan, E., *Marine Encyclopaedic Dictionary*, London, Lloyd's of London Press Ltd., 1988.

Task Force on Deep-Sea Fishing, *Report to the Minister of Transport*, Ottawa, Supply and Services, 1985.

Thomas, J. and Meyer, M., *The New Rules of Global Trade: A Guide to the World Trade Organization*, Toronto, Carswell, 1997.

Transport Canada (J.-F. Pelletier), *Analysis of the foreign-registered fleet's share of Canadian merchant shipping* (public version), Ottawa, 1997(?).

\_\_\_\_\_, *Annual Report 1997*, Ottawa, <http://www.tc.gc.ca>.

\_\_\_\_\_, *T-Facts*, <http://www.tc.gc.ca>

U.S. Bureau of Transportation Statistics, "Maritime Industry: Cargo Preference Laws--Estimated Costs and Effects", Report to Congressional Requesters, <http://www.bts.gov>.

U.S. Maritime Administration (MARAD), *Maritime Subsidies*, Washington, Department of Transportation 1993.

\_\_\_\_\_, *A Report to Congress on U.S. Maritime Policy*, Washington D.C., Department of Transportation, May 1998, <http://marad.dot.gov>.

\_\_\_\_\_, "Title XI Program", <http://marad.dot.gov>.

\_\_\_\_\_, *Merchant Marine Act* (1936), <http://marad.dot.gov>

U.S. International Trade Commission, *Recent Trends in U.S. Services Trade: 1997 Annual Report*, investigation no. 332-345, publication 3041, Washington D.C., May 1997.

United Nations Conference on Trade and Development (UNCTAD), *Review of Maritime Transport 1997*, New York, United Nations Publications, 1997.

White, L. J., *International Trade in Ocean Shipping Services: The United States and the World*, Cambridge (Mass.), Ballinger Publishing, 1988.

World Trade Organization (WTO), *WTO International Trade Annual Report*, vol 2.

\_\_\_\_\_, "Maritime Transport Services", Background Note by the Secretariat, doc. S/C/W/62, 16 November 1998.

Yannopoulos, G.N. (ed.), *Shipping Policies for an Open World Economy*, London, Routledge, 1989.



















3 1761 11553580 9

